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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, OCTOBER 6, 2000

APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUE000009

For approval of expenditures
For new generation facilities
And for a certificate of public
Convenience and necessity

and

For approval and certification
of transmission facilities

FINAL ORDER

On January 21, 2000, Virginia Electric and Power Company ("Virginia Power" or "the Company") filed an application requesting Commission approval for expenditures pursuant to § 56-234.3 of the Code of Virginia to construct two simple cycle combustion turbine ("CT") generator units of approximately 160 megawatts ("MW") each. The proposed units are to be usually gas-fired, but also capable of firing on fuel oil. The total cost of both units will be approximately \$97.5 million, or \$305 per kW.

The Company also requested a certificate of public convenience and necessity pursuant to § 56-265.2 to construct the proposed facility. The proposed facility is to be located

in Caroline County near the town of Ladysmith and the Company's Ladysmith Substation.

Virginia Power proposes commercial operation of the units on or about June 2001. According to application, the new generating units will meet a portion of the Company's increased capacity requirements for the 2001 and subsequent years. The Company states that the proposed facility will have minimal adverse effects on the environment, noting that it will operate for relatively few hours each year, will normally be fueled by natural gas, and will not require large amounts of cooling water. The Company filed the testimony of E. Paul Hilton, Edward J. Rivas, Daniel J. Green,¹ and Jeffrey L. Jones in support of its application.

Virginia Power also filed an application on January 21, 2000, requesting a certificate of public convenience and necessity for the construction and operation of approximately four miles of 230 kV transmission line to connect the two proposed generating units to the Company's existing transmission facilities. This application was supported by the prefiled testimonies of Michael J. Chupka, John B. Bailey, and James A. Cox. The Company's two applications were docketed in the Commission's Order for Notice and Hearing of February 16, 2000,

¹ Mr. Green's testimony was adopted by Charles A. Stadelmeier at the hearing.

and consolidated and merged into a single proceeding under Case No. PUE000009.

Dynegy Power Corp. ("Dynegy") filed as a Protestant in this proceeding. Dynegy is a subsidiary of Dynegy Inc., an independent power producer with interests in power generation facilities located in Virginia, California, Texas, Georgia, Michigan, and Nevada, having generation capacity exceeding 8,000 MW. Dynegy filed the testimony of David L. Cruthirds on April 6, 2000.

The Commission Staff investigated the Company's applications and filed the testimonies of Cody D. Walker, Massoud Tahamtani, and Mark K. Carsley on April 25, 2000.

Virginia Power's application was heard before Chief Hearing Examiner Deborah V. Ellenburg on May 23 and 24, 2000. Edward L. Flippen, Kodwo Ghartey-Tagoe, Guy T. Tripp III, and Jill C. Hayek appeared as counsel for the Company. Thomas B. Nicholson appeared as counsel for Dynegy, and C. Meade Browder Jr. and Marta B. Curtis appeared on behalf of the Commission Staff. Floyd W. Thomas Jr., Chairman of the Caroline County Board of Supervisors, appeared as a public witness in support of the Company's application. No other public witnesses appeared.

The Chief Hearing Examiner issued her report on August 7, 2000. The report discusses in detail Virginia Power's evidence in support of its application, the Staff's evaluation of the

application, and Dynegy's position in opposition to the application.

The examiner noted that the Company initially sought approval of these two CTs in an application filed August 11, 1998, in which it requested approval of five CTs at either a site near Remington in Fauquier County, or the Ladysmith site.² Virginia Power ultimately withdrew its request to construct units at the Ladysmith site and amended its application to seek authority to construct only four CTs at the Remington site. We approved that amended application on May 14, 1999.

In the instant application, the Company offered its current load forecast showing continuing growth in demand in its service territory resulting in additional peak capacity needs of 810 MW in 2001, 1001 MW in 2002, and 1,179 MW in 2003. Virginia Power issued a competitive solicitation for additional capacity through a December 10, 1999, Request for Proposals ("RFP"). The Company stated that its initial evaluation of the bids received indicated the bids were not competitive with the Company's build option for the incremental needs to be satisfied by the proposed Ladysmith CTs. The Company stated that it has contracted for capacity from independent sources as a result of a January 1999 RFP required by the Commission in Case No. PUE980462. Virginia

² See Application of Virginia Elec. and Power Co. ("the Remington application"), Case No. PUE980462, 1999 S.C.C. Ann. Rep't 431.

Power is negotiating contracts based on other proposals from the January RFP for capacity in 2000 and 2001, and will be continuing to evaluate bids from the December RFP to fill the remainder of the Company's needs for 2001 and 2002.

Virginia Power stated that the facilities necessary to connect the proposed CTs to the Company's transmission system require the following: approximately four miles of new 230 kV line between the CTs and the Company's Ladysmith Substation; a 500 kV breaker, a 500 - 230 kV, 840 MVA transformer, a 230 kV breaker at the substation; and three 230 kV breakers at the CT site. The estimated cost to connect the CTs to the transmission system at Ladysmith is approximately \$12 million. All of the new line will be on either existing transmission line right-of-way or on Company-owned property.

The Staff's testimony recommended approval of Virginia Power's application. It assessed the need of the proposed units by considering the reasonableness of the Company's forecasted loads, planning criteria, and whether there are economic alternatives. Staff witness Carsley noted that the Staff determined Virginia Power's forecasting methodology was reasonable during its annual review of the Company's latest filed resource plan and in the Company's 1999/2000 fuel factor case. The Staff found Virginia Power's summer peak load forecasts for 2001, 2002, and 2003 to be consistent with its

previous forecasts even though the Company's capacity needs forecast did not reflect any loss of load associated with its retail customer choice pilot program. The Staff reasoned that estimating the amount of load loss to competitive generation would be too speculative to factor into the forecasts.

Staff witness Walker accepted Virginia Power's use of a 12.5 percent reserve margin. Mr. Walker also reviewed Virginia Power's evaluation of the bids it received in response to its December 1999 RFP for power supply. Mr. Walker generally concurred with Virginia Power's conclusion that the proposed CTs at Ladysmith will impose less cost on the Company and or provide greater reliability than any of the outside proposals.

The Staff addressed market power implications of the proposed units. Mr. Carsley explained how Virginia Power's increased capacity could serve to restrict entry by potential competitors and could possibly raise generation costs to competing suppliers within the Company's control area. The Staff concluded, however, that the summer peak load forecasts coupled with Virginia Power's continued service obligation to serve customers in its territory outweighed the Staff's concern over the Company's increased market power that would likely result from construction of the proposed units.

The Department of Environmental Quality ("DEQ") coordinated a review of the environmental impacts of the proposed

facilities, and the Staff incorporated the DEQ report within its prefiled testimony. The report included a number of recommendations. DEQ found that the project, provided it is constructed in accordance with all recommendations, is unlikely to have significant effects on water quality, wetlands, or geology features, and will not affect rare, threatened, or endangered species of plants. The Staff recommended that the Company be directed to undertake the actions identified in the DEQ review to minimize the potential impacts to natural resources that would not otherwise be required by the various permits and approvals required for the project.

Staff witness Tahamtani prepared a report relative to the 230 kV transmission line to connect the proposed CT units to Virginia Power's Ladysmith substation. Mr. Tahamtani found that transmission facilities are required to connect the proposed CTs to the Company's transmission network, and he agreed with the Company that the new transmission facilities as proposed provide the best technical and economical option available.

The Staff recommended that Virginia Power be granted a certificate to construct and operate the two 160 MW CT units at Ladysmith as proposed, and that a certificate be granted to authorize the construction and operation of the proposed 230 kV transmission facilities.

Dynegy opposed the Company's application. It had submitted an unsuccessful bid in response to the January 1999 RFP.

Dynegy's witness, Mr. Cruthirds, argued at length that Virginia Power possesses market power in its control area due to its concentrated ownership of generation and control over transmission facilities. He asserted that the public interest would be best served by not permitting the Company to build additional generation. Virginia Power offered the rebuttal testimony of Mr. Hilton in response to Dynegy's assertions.

The Chief Hearing Examiner discussed in her report the applicable law under Title 56 of the Code of Virginia and the Commission's case law. She noted that for incumbent electric utilities a certificate application such as this must still be evaluated on the basis of need. The examiner found that there was no question that a clear need exists for additional generation capacity in Virginia Power's service territory. She further found that the bids from the Company's two RFPs were evaluated appropriately and that the proposed Ladysmith units represent the least cost and most reliable option available to serve a portion of the Company's need beginning June 2001.

The examiner noted that Virginia Power's Mr. Rivas stated that the Company would be taking the recommended precautions outlined in the DEQ report in the construction at the site, and

that it intended to comply with all suggested conditions so as to mitigate environmental impacts.

The Chief Hearing Examiner cited to our final order on Virginia Power's Remington application to conclude that it is clear that the Company continues to hold market power. In that order we said, "the Company now has substantial market power over the provision of electric utility service within its current service territory, and will continue to possess such market power for the foreseeable future."³ To counter Virginia Power's argument that the record in the instant proceeding does not support a finding of market power, the examiner noted that there has been no significant change in the level of non-affiliated generation in the Company's control area.

Notwithstanding the market power concern, the examiner recognized that Virginia Power retains the obligation to serve within its designated service territory, and found that the record supports a finding that additional capacity is needed and that the proposed Ladysmith CTs are the most cost-effective and reliable option available for a portion of the need. She further found that the Company's proposal for connecting the CTs to the Ladysmith Substation provides the best option available

³ 1999 S.C.C. Ann. Rep't at 433.

and will reasonably minimize any adverse effect on the environment.

Virginia Power and Dynegy filed comments in response to the Chief Hearing Examiner's report.

Virginia Power's comments urge the Commission to adopt the examiner's findings and recommendations regarding the public convenience and necessity for the proposed CTs and related transmission facilities. It also, however, takes strong exception to the market power analysis contained in the report. According to the Company, the record in this case contains no evidence that supports the examiner's findings in this area. It contends the evidence on market power offered by Dynegy "was totally lacking in weight and credibility." According to the Company, the Commission's opinion in another docket does not qualify as facts in this docket.

Dynegy's comments reiterate its view that the public interest is best served if all of Virginia Power's incremental capacity needs are met through purchases from non-affiliated suppliers. While Dynegy agrees with many of the examiner's findings on the Company's market power in generation, it disagrees with her conclusion that there are safeguards in place to control any abuse of that market power. Dynegy requests that we deny Virginia Power's application.

Prior to the Chief Hearing Examiner's report, the Company had filed on July 27, 2000, a motion requesting interim authority to make financial expenditures and to undertake preliminary construction work for the proposed facility. This motion, in essence, renewed an earlier Company motion of May 4, 2000. In its July 27 motion, however, Virginia Power advised for the first time that it "would incur significant cost if construction begins no later than August 1."

On July 28, 2000, the Chief Hearing Examiner issued a ruling advising us that her report recommending approval of the proposed Ladysmith CT units was imminent, and therefore recommended that we grant the Company's motion for interim authority. Later on July 28, 2000, the Commission entered an order on Virginia Power's motion authorizing the Company to make financial expenditures and undertake preliminary construction of pilings and footers for the proposed project at Ladysmith.

NOW THE COMMISSION, upon consideration of the record established herein, the comments on the Chief Hearing Examiner's report, and the applicable law, is of the opinion and finds that the recommendations of the Chief Hearing Examiner are reasonable and should be adopted.

It appears that the one issue in this case that remains in controversy is market power. In our order in the Company's Remington application last year, we stated that we were

"convinced upon the record before us that Virginia Power now has, and will continue to have, the ability to exercise market power over the generation and supply of electricity in a large portion of the Commonwealth."⁴ As noted above, the Company contends that the record in this case contains no evidence to support a finding that Virginia Power has such market power. Virginia Power states in its comments to the Chief Hearing Examiner's report that, "[t]he only evidence offered on market power was by Mr. Cruthirds, and it was totally lacking in weight and credibility."⁵ The Company is incorrect in at least one respect. The Staff's testimony in this case addressed the Company's market power with specificity, and the Company's comments failed to contradict or even to mention this additional evidence. We continue to conclude that Virginia Power possesses market power over the generation and supply of electricity in its service area.

We find, however, that the public convenience makes it necessary for the Company to construct the proposed units to meet the service needs of its customers. These units will meet only a portion of Virginia Power's forecasted incremental capacity needs for 2001 through 2003, and we expect the Company

⁴ Remington Application, 1999 S.C.C. Ann. Rep't at 432.

⁵ Comments of Virginia Power at 2.

to continue to negotiate with bidders to its RFP to fulfill its additional capacity needs.

While we are approving the Company's application, as we stated in our order on the Company's Remington application, the Commission stands ready to take all necessary actions permitted by law to mitigate market power, to ensure that the operation of the generating units of incumbent utilities will not inhibit the development of competition within the Commonwealth, and to carry out the purposes of the Virginia Electric Utility Restructuring Act.⁶

Accordingly, IT IS ORDERED:

(1) The findings and recommendations of the Chief Hearing Examiner's August 7, 2000, report are hereby adopted.

(2) The interim authority to make financial expenditures and to undertake preliminary construction of pilings and footers granted by order of July 28, 2000, is hereby made final.

(3) Pursuant to § 56-234.3 of the Code of Virginia, Virginia Electric and Power Company is authorized to make expenditures to construct two 160 MW combustion turbine electric generators at Ladysmith in Caroline County, and as more fully described in the Company's application filed January 21, 2000.

⁶ Section 56-576 et seq. of the Code of Virginia.

(4) Pursuant to § 56-265.2 of the Code of Virginia, Virginia Electric and Power Company is hereby granted Certificate of Public Convenience and Necessity No. ET-159 to construct and operate the two 160 MW combustion turbine electric generators identified in ordering paragraph (3) and as more fully described in the Company's application of January 21, 2000.

(5) Pursuant to §§ 56-46.1 and 56-265.2 of the Code of Virginia, Virginia Electric and Power Company is hereby granted Certificate of Public Convenience and Necessity No. ET-70f authorizing the Company to construct approximately four miles of 230 kV transmission line, a 500 kV breaker, a 500 - 230 kV, 840 MVA transformer, a 230 kV breaker at the Ladysmith Substation; and three 230 kV breakers at the CT site, as more fully described in the Company's application of January 21, 2000, to connect the generating units approved herein to the Company's existing transmission facilities in Caroline County.

(6) Virginia Electric and Power Company shall comply with all conditions identified in the recommendations of the Chief Hearing Examiner's August 7, 2000, report so as to minimize any adverse impact on the environment caused by the construction authorized herein.

(7) The approvals granted herein are for the specific facilities authorized by this Order and as described in Virginia

Electric and Power Company's applications of January 21, 2000.

The Company shall forthwith advise the Commission of any proposed changes to the facilities or construction practices from that which has been proposed and approved herein.

(8) There being nothing further to come before the Commission in this proceeding, this case shall be removed from the docket and the papers transferred to the file for ended causes.